

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF VERMONT**

In re:

JEAN HELEN THERRIAULT,
Debtor.

Chapter 13 Case
00-11001

In re:

JEAN HELEN THERRIAULT,
Plaintiff,

v.

RUSSELL SCHAEFER,
Defendant.

Adversary Proceeding
#**00-1063**

Appearances:

*Rebecca A. Rice, Esq.
Cohen & Rice
Rutland, VT
Attorney for Defendant*

*Geoffry F. Walsh, Esq.
Meris Bergquist, Esq.
Vermont Legal Aid, Inc.
Springfield, VT
Attorneys for Debtor/Plaintiff*

*Melissa Ranaldo, Esq.
Office of U.S. Attorney
Rutland, VT
Attorneys for Rural Housing
Service,
U.S. Dept. of Agriculture*

**MEMORANDUM OF DECISION
GRANTING PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT
AND OVERRULING CREDITOR'S OBJECTION TO CLAIM**

On March 9, 2001, the debtor/ plaintiff filed a Motion for Summary Judgment [Dkt.# 8-1] in this adversary proceeding requesting that the Court enter an Order deeming the claim of the defendant/creditor, Russell Schaefer (hereafter "the creditor"), to be an unsecured claim pursuant to

11 U.S.C. §506(a) and not governed by the anti-modification provisions of 11 U.S.C. §1322(b)(2), and also avoiding the creditor's lien pursuant to 11 U.S.C. §506(d). On April 19, 2001, the creditor filed an Objection to the Claim [Dkt.#33-1] of the U.S.D.A. Rural Housing Services, Inc. (hereafter "RHS") in the main [chapter 13] case seeking a reduction in the value of the RHS' secured claim. The two matters involve the same legal and factual issues and therefore have been joined for consideration by the Court and will be treated as a single dispute for purposes of the analysis undertaken in this ruling. This Court has jurisdiction over this dispute pursuant to 28 U.S.C. §§ 157 and 1334. For the reasons set forth below, the motion for summary judgment is granted and the objection to claim in the main case is overruled.

1. Background

The pertinent facts underlying this dispute are straightforward and undisputed. The plaintiff/debtor, Jean Helen Therriault (hereinafter the "debtor"), owns her home in Brattleboro, Vermont, which she occupies as her principal residence. She purchased the premises in 1984 with a loan from the Farmers Home Administration (hereafter "FmHA"), under Title 5 of the Housing Act of 1949, 42 U.S.C. 1472, *et seq.* ("the Act"). The FmHA mortgage was executed on May 15, 1984. The FmHA mortgage states: "[T]his instrument also secures the recapture of any interest credit or subsidy which may be granted to the Borrower by the Government pursuant to 42 USC §1490a."

Section 1490a essentially provides the Secretary with the power to grant a qualified rural housing borrower assistance in the form of credits by reducing the effective interest rate, thus lowering the qualified buyer's monthly payment in order to make housing more affordable for low-income homeowners. *See* 42 U.S.C. §1490a(a)(1)(B). The Act further directs the Secretary to provide for the recapture of "all or a portion of such assistance rendered upon the disposition or non-

occupancy of the property by the borrower.” 42 U.S.C. §1490a(a)(1)(D)(i). The Secretary’s regulations dealing with loan servicing, subsidies and recapture of interest credits are found at 7 C.F.R. Part 3550.151, Subpart D.

While the Note executed pursuant to the FmHA loan transaction with the debtor established a monthly mortgage payment of \$476.00, the amount actually required to be paid by the debtor varies based upon her current income. The debtor’s actual contribution to the mortgage payment is determined pursuant to annually renewing subsidy agreements, whereby her contribution to the Note payment is limited to an affordable level based upon her income. Any difference between the monthly amount due under the loan documents and the borrower’s contribution constitutes a monthly “subsidy” by the government. Therefore, with each monthly mortgage payment, the cumulative amount of the subsidy provided by the government increases.

On September 8, 2000, the debtor filed for bankruptcy relief under chapter 13 of title 11 U.S.C. (“the Bankruptcy Code”). In response, the RHS, as successor to FMHA, filed a proof of claim indicating that the debtor was indebted to the government for a secured claim in the amount of \$87,521.09¹. This claim is comprised of the principal due on the note in the amount of approximately \$20,766, plus \$60 in accrued interest to the filing date the petition, added to approximately \$66,980 attributed to the interest credit subsidy that has been granted to the borrower pursuant to the Act and regulations, which RHS claims to be subject to recapture.

In March, 1997, prior to filing her petition for bankruptcy relief, the debtor had granted a

¹ It should be noted that a slight discrepancy is apparent between the RHS’s proof of claim filed in the amount of \$87,521.09 and the aggregate amount of \$87,808.41 submitted in its papers regarding this pending dispute. It appears that the difference may be attributed to additional accruing interest credit subsidies. For purposes of resolving the pending summary judgment motion in the adversary proceeding and the creditor’s objection to proof of claim in the main case, the discrepancy is inapposite to the issues before the Court.

mortgage on her residence to the creditor, Russell Schaeffer, as security for payment of an interest-free Note between the parties in the amount of \$5,000 (hereafter the “Schaeffer second mortgage”). The Note provides that the debtor would submit regular monthly payments to Mr. Schaeffer in the amount of \$100 and that she also would pay all reasonable collection costs, including attorneys fees, in the event of default. Based upon this transaction, the creditor filed a proof of claim in the amount of \$6,080, which includes the principal amount due, plus other charges, characterizing the debt as a secured claim. The Schaeffer second mortgage provides in part:

The foregoing premises are subject to a mortgage deed given by the Grantor herein to Farmers Home Administration dated May 15, 1984, recorded in book 178, page 81, of the Brattleboro land records.

There is no dispute that the fair market value of the residence in October, 2000 [shortly after bankruptcy filing herein] was \$71,000. The creditor does dispute, however, the amount of the accumulated subsidies and the extent to which these accumulated subsidies may be considered in determining the extent of the RHS’ claim. Depending upon the allowed amount of the RHS claim, the debtor contends that the creditor’s claim may be undersecured and, therefore, subject to modification under 11 U.S.C. §1322(b)(2), which provides that a chapter 13 plan may not modify the rights of holders of secured claims if the claim is secured only by a security interest in real property that is the debtor’s principal residence. The debtor’s chapter 13 plan treats the creditor’s claim as unsecured.

In order to avoid the disadvantage of being totally unsecured on his second mortgage, the creditor asserts that RHS is only secured to the extent of \$62,600 after applying the value appreciation formula set forth in paragraph 6(g) of the underlying Subsidy Repayment Agreement (“the Agreement”). Paragraph 6(g) sets forth a formula for determining the appropriate recapture

amount under circumstances involving either the voluntary sale of debtor's real property or the repayment of the entire principal and interest balance of the RHS loan.

A dispute has thus arisen between the debtor and the creditor regarding the amount of the RHS claim and whether there is any equity to which the creditor's claim can attach, so that it might be treated as a secured claim under §506(a) and be exempt from modification under §1322 (b)(2). On November 8, 2000, the debtor commenced an adversary proceeding seeking a determination that the claim held by the creditor was effectively unsecured pursuant to §506(a) and seeking to have the lien avoided pursuant to §506(d).

As pointed out by RHS in its Response to Creditor's Objection to Claim, there are several potential contingencies under the Agreement that govern the debtor's legal obligation to repay the interest credit subsidy. In seeking a lower valued determination of the amount attributable to the RHS claim, the creditor favors a calculation based upon circumstances where the debtor voluntarily relinquishes the property. RHS favors a higher valued determination of its claim based upon paragraph 4 of the Agreement, and argues that the more applicable computation is the one which would apply when the debtor continues to own and occupy the premises, makes monthly payments of principal and interest, and defers repayment of the subsidy until the property is no longer owner occupied. Under these arguably more analogous circumstances, RHS argues that the amount of subsidy to be repaid is not determined until the principal and interest balance is fully paid. RHS points out that paragraph 4 specifically provides that the mortgage securing the loan remains in effect and will not be discharged "until the total amount owed the government has been repaid."

Lastly, RHS directs the Court's attention to 7 C.F.R. §3550.211(f) indicating that when a subordinate lienholder forecloses, RHS must either be paid in full or, if not, then pursuant to 7 C.F.R. §3550.211(a), the debtor's account will be liquidated and RHS "may pursue any deficiency" against the debtor. It is undisputed that the debtor continues to occupy the property and make current principal and interest payments on the loan, but has deferred repayment of the subsidy

amounts granted.

2. Issue

The issue presented is whether the value of the RHS's claim exceeds the fair market value of the debtor's property thereby rendering the second mortgage held by the creditor wholly unsecured under §506(a) and subject to modification pursuant to §1322(b)(2).

3. Summary Judgment Standard

It is well settled that summary judgment is proper only if the record shows that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law. Rule 56(c), Fed.R.Civ.P.; Bankruptcy Rule 7056, Fed.R.Bankr.P. A genuine issue exists only when "the evidence is such that a reasonable [trier of fact] could return a verdict for the nonmoving party." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248, 106 S.Ct. 2505, 2510, 91 L.Ed.2d 202 (1986); *see also* Celotex Corp. v. Catrett, 477 U.S. 317, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986)(movant need only illustrate by reference to record plaintiff's failure to introduce evidence in support of essential element of claim). "The substantive law will identify which facts are material. Only disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment." Liberty Lobby, 477 U.S. at 247, 106 S.Ct. at 2509. Factual disputes that are irrelevant or unnecessary are not material. Id. Furthermore, materiality is determined by assessing whether the fact in dispute, if proven, would satisfy a legal element under the theory alleged or otherwise affect the outcome of the case. Id.

The court must view all the evidence in the light most favorable to the nonmoving party, Valley Liquors, Inc. v. Renfield Importers, Ltd., 822 F.2d 656, 659 (7th Cir.), *cert. den.*, 484 U.S. 977 (1987), and draw all inferences in the nonmovant's favor. Santiago v. Lane, 894 F.2d 218, 221 (7th Cir. 1990). However, if the evidence is merely colorable, or is not significantly probative or merely raises "some metaphysical doubt as to the material facts," summary judgment may be granted.

Liberty Lobby, 477 U.S. at 249-50, 106 S.Ct. at 2510-11; Matsushita Electric Industries Co. v. Zenith Radio Corp., 475 U.S. 574, 586, 106 S.Ct. 1348, 1355, 89 L.Ed.2d 538 (1986). In making its determination, the court's sole function is to determine whether there is any material dispute of fact that requires a trial. *See* Waldridge v. American Hoechst Corp., 24 F.3d 918 (7th Cir. 1994). Credibility determinations, weighing evidence, and drawing reasonable inferences are jury functions, not those of a judge deciding a summary judgment motion. Liberty Lobby, 477 U.S. at 255, 106 S.Ct. 2513-14.

4. Discussion

This dispute centers on the value of the RHS' claim and whether the remaining equity, if any, in the debtor's residential real property renders the Schaeffer second mortgage wholly unsecured under §506(a), subject to modification under §1322(b)(2), and subject to lien avoidance under §506(d). It has recently been determined in this Circuit that the anti-modification protections of §1322(b)(2) do not extend to wholly unsecured junior mortgages. *See* In re Pond, 252 F.3d 122 (2nd Cir. 2001). In Pond, chapter 13 debtors brought an adversary proceeding to avoid a junior mortgage lien on their residence. The Second Circuit held that a junior mortgagee's interest in a debtor's principal residence was not secured, and thus the chapter 13 anti-modification exception did not protect the junior mortgagee from having its lien avoided, where there was insufficient equity in the subject property to cover any portion of their lien. Id., at 127. After a comprehensive discussion of the anti-modification protections under the Bankruptcy Code, the Second Circuit recognized that the chapter 13 exception only protects a creditor's rights in its mortgage lien where the debtor's residence retains enough value, after accounting for all other encumbrances that have priority over the lien, so that the lien is at least partially secured. Thus, a wholly unsecured mortgage is not protected under the chapter 13 anti-modification provisions. In this instance, if the Schaeffer second mortgage is wholly unsecured after taking into account the RHS's first mortgage lien, then the creditor's claim is subject to modification under the debtor's chapter 13 plan. Hence, the value of

the RHS claim is determinative of this controversy.

In deciding the value of the RHS first mortgage claim, this Court essentially adopts the positions advocated by the debtor and RHS regarding the proper interpretation and application of the subject loan agreements and regulations, the position of the legal authorities they rely upon, and concludes that the value of the RHS claim exceeds the value of the subject collateral, thereby rendering the Schaeffer second mortgage unsecured under §506(a), subject avoidance under §506(d), and subject to modification under §1322(b)(2).

In construing the pertinent provisions of the subject loan documents and applicable statute and related regulations, this Court is guided by the analysis in Allen v. U.S. Dept. of Agriculture, Farmers Home Admin., 698 F. Supp. 669 (S.D. Miss. 1988). In Allen, as here, the borrowers received a housing loan from FmHA (now “RHS”) under the Act. The loan was subject to the same basic provisions indicating that the loan agreement also secured the recapture of any interest credit or subsidy extended by the FmHA to the borrower. When the borrowers in Allen sought to refinance their residence and maintain occupancy, they determined to pay-off the FmHA loan. In providing the pay-off figure, the FmHA sought to recover not only the outstanding principal and interest balance on the loan, but also the interest credit recapture amount as well. The Allen court found that the loan agreements and security instrument stated in plain language that payments made under the interest payment agreements are subject to recapture under the Act and related regulations. While the Allen case involved refinancing and the instant dispute involves a debtor in chapter 13 bankruptcy, the circumstances are sufficiently analogous to support and require the same outcome. As indicated by the RHS and the debtor, the limited provisions relied upon by the creditor are simply not applicable to the debtor’s circumstances where she remains in occupancy of her residence, is current on her RHS mortgage obligations, and intends to continue to occupy the premises and make monthly payments.

Based upon the foregoing, the debtor’s motion for summary judgment is granted and the

objection to the RHS claim filed by Mr. Schaeffer is overruled. The claim of the RHS is allowed as filed and the claim of Mr. Schaeffer shall be allowed as unsecured; the claims shall be treated accordingly in the chapter 13 plan.

January 31, 2002
Rutland, Vermont

Colleen A. Brown
U.S. Bankruptcy Judge